VAT planning tips

1. Sales promotion

Price vs. quantity discount

Sales discount is deductible from the amount of gross sales if the information for the sales discount is included in the same VAT special invoice issued upon the sale of goods. Separate invoices will not be acceptable for purpose of reducing the sales amount under the VAT rules. Note that the VAT rules refer to the price discount not quantity discount. Under the PRC accounting rules, the sale revenue for goods supplied under quantity discount is the same for the goods supplied under price discount. However, the goods supplied under quantity discounts are gifts and they are deemed to be sales under the PRC VAT rules. In the case of sales promotion, the buyer is indifferent if he gets a buy-one-get-one-free offer (a quantity discount) or a 50 percent price discount. However, the VAT impact on the seller is significantly different. Take a numerous example: if a certain good has a selling price of RMB1,000, the taxable base in the buy-one-get-one-free is RMB2,000 for reason that the quantity discount is deemed to be a sale. The taxpayer's VAT liabilities will be 17% x RMB2,000 = RMB340; however the taxable base in a 50 percent price discount is only RMB1000 (= 2000 x 50%) and the tax liabilities will be 17% x RMB1,000=RMB170 accordingly. Therefore, the seller can save a lot in the price discount option.

2. Use of sales company or agent

A foreign investment enterprise (the FIE) owns a foreign invested commercial enterprise (FICE), which is a trading company. It can choose whether the subsidiary FICE acts as a "sales company" or a commission agent. The VAT consequences are different for different way of distributing the goods. An example is used as illustration:

Option A: The selling price of a product is RMB1,000. For each product sold, the subsidiary receives a commission of RMB200.

Option B: the subsidiary buys the products from the FIE at RMB800 each piece of product.

The following illustrates that the "sale company" option is more tax efficient. Remember that VAT is not double tax in nature since the VAT rules provide for input credit, but business tax is double tax since it does not have input credit, in the absence of specific provisions.

These are illustrated in the following table:

	Sales Company (Option A)	Commission agent (Option B)
1	VAT (FIE) = 800 x 17% = 136 VAT (Subsidiary) = (1000 – 800) x 17% = 34	VAT (FIE) = 1000 x 17% = 170. VAT (FICE) = 1000 x 17% - 1000 x 17% = 0
2	Nil	Commission is subject to 5% business tax (200/1000) / 100% = 20% = 1000 x 20% * 5% = 10
	Total VAT: 136 + 34 = 170	Total VAT: 170 + 10 = 180

There is a difference between the PRC accounting rule and the VAT rules. Under option B, the FIE (principal) has to issue VAT special invoice to the FICE (agent). In turn, the FICE has to issue VAT special invoices to the buyer. The deemed sale provision in the VAT rules provides that the both the principle and the agent has to issue tax invoice even if there is no transfer of legal ownership. The PRC VAT rules treat the agent to be an entity on its own. Where the transaction is structured as a consigned sale, the PRC accounting rules provide for two alternative treatments. The agent (FICE) may record the transaction as a sale in its book of accounts. It may also report a commission income and exclude the consigned sales from revenue. If the FICE records the transaction as a sale in the income statement, the form of the accounting treatment departs from the substance of the transactions even though there only exists a principle-agent relationship between the two parties. That is typical case in the wholesale business in China.